

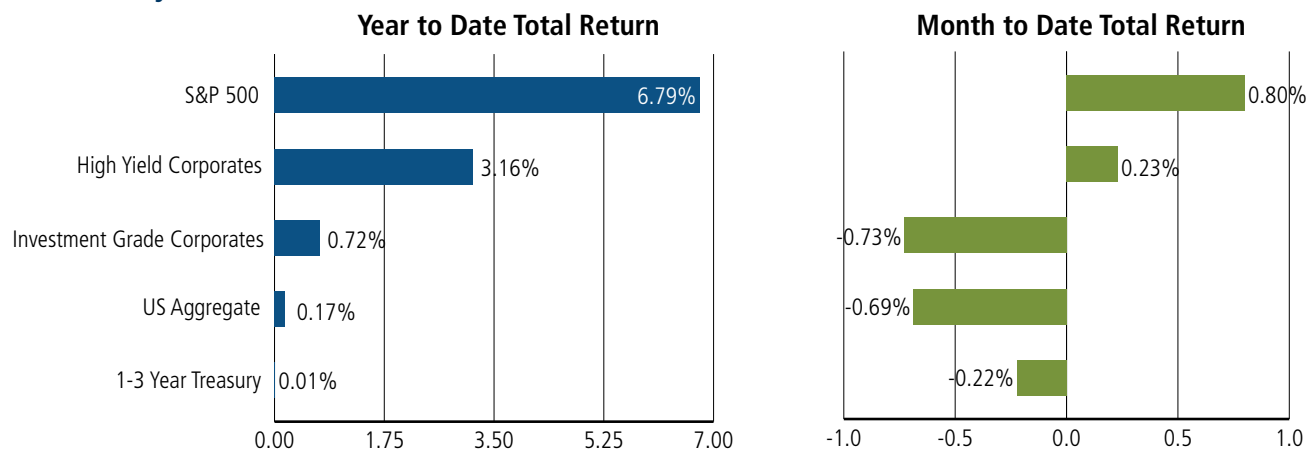
Week Ending March 3, 2017

Bond Market Tells Fed to Take a Hike

Economic Overview:

The market has suddenly changed its mind about the chance of an interest rate hike from the U.S. central bank at the March 14-15 FOMC meeting ([see chart here](#)). As of early February, the market maintained a 75% probability of no hike at the March monetary maven meet-up. This week, that same market placed a 90% probability of one hike. What changed the market's mercurial mind? Dallas Fed President Robert Kaplan spoke of monetary "normalization" via rate hikes and balance sheet reduction. Fed Governor Lael Brainard all but sealed the deal in a speech Wednesday, where her formerly dovish assessment of the U.S. and global economic backdrop was replaced by a more balanced view, including a comment that the Fed could hike "soon" (March?) without risking much.

Total Returns by Asset Class



Highlights of the Week:

- **Treasuries:** Economic data took a backseat to hawkish fed speak this week as yields backed up 25bps in the belly and short end of the curve and 15-20 bps in the long end. NY Fed President Dudley's CNN interview, where he stated "a case for tightening has become a lot more compelling", triggered a sell off early in the week and exacerbated the yield curve's flattening.
- **Equities:** The U.S. equity market posted its sixth consecutive weekly gain as President Trump's address to Congress was surprisingly conciliatory. Later in the week, investors shifted their focus on the initial public offering of Snap Inc. The social media company has yet to report a profit, but that didn't stop shares of SNAP jumping 44% higher on the first day of trading.
- **Corporates:** All consumers rejoice! Cell phone plans have become increasingly competitive as price wars between the top providers have grown. As evidence, Verizon recently joined its compatriots in offering an unlimited data plan while other companies have decreased prices or thrown in freebies to keep their customers happy. Moody's has put the telecommunications industry on negative outlook as it grapples with a changing environment.
- **Securitized Products:** The annual Structured Finance Industry Group (SFIG) Vegas conference concluded on Wednesday with the most positive tone in recent memory. "Making Sense of Trump's First Manic Month" was the topic for keynote speaker, Joe Scarborough of MSNBC's Morning Joe, and that theme spilled over to the rest of the conference. While attendees were sullen last year due to all of the regulatory reforms, these same people are seeing a glimmer of hope with positive regulatory change in the future.
- **High Yield:** Declining default rates over the past several months are a sign of market health following the commodity-driven default cycle of the past two years. As medium-term default risk remains low across sectors, prudent investors should take advantage of headline-driven, technical weakness to add to issuers with strong fundamentals.
- **Emerging Markets:** Both the government and Caixin readings of China's manufacturing PMI came above expectations at 51.6 and 51.7, respectively, and each showed improvement versus January. Prints in Mexico were mixed; the Markit manufacturing PMI was resilient at 50.6, while the government reading fell to 46.8. Indonesia's manufacturing PMI eased to 49.3, India's PMI ticked higher to 50.7, Russia's manufacturing PMI fell but remained in expansionary territory at 52.5, and Turkey's data improved but remained in contractionary territory at 49.7.
- **Currencies:** While most currencies were selling off against the U.S. dollar this week on the back of rising expectations of a Fed rate hike in March, the Swedish krona was one exception. Stronger than expected Swedish GDP growth numbers together with rising retail sales and a positive trade balance for January provided support to the krona. The Swedish currency, which has been rising against the euro since November last year, looks set to continue this trend, albeit at a gradual pace given the dovish stance of the Riksbank.
- **Municipals:** The municipal market outperformed Treasuries this week, as Treasury yields increased and ratios declined across the curve. While supply was again subdued this week, 30-day visible supply increased over 20% from last week.

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